

**MINUTES  
REGULAR MEETING  
ARIZONA STATE RETIREMENT SYSTEM BOARD**

**Friday, November 18, 2005  
8:30 a.m., MST**

The Arizona State Retirement System (ASRS) Board met in the 10<sup>th</sup> Floor Board Room, 3300 N. Central Avenue, Phoenix, Arizona. Dr. Keith Meredith, Chair of the ASRS Board, called the meeting to order at 8:36 a.m., MST.

The meeting was teleconferenced to the ASRS office at 7660 E. Broadway, Tucson, Arizona 85710.

**1. Call to Order; Roll Call; Opening Remarks**

Present: Dr. Keith Meredith, Chair  
Mr. Karl Polen, Vice Chair (via teleconference)  
Mr. David Byers  
Mr. Chris Harris  
Mr. Michael Townsend  
Mr. Lawrence Trachtenberg  
Mr. Steven Zeman (via teleconference)

Absent: Mr. Jaime Gutierrez  
Ms. Anne Mariucci

A quorum was present for the purpose of conducting business.

**2. Approval of the Consent Agenda**

**2E(ii) – William Knepfle**

Mr. William Knepfle addressed the Board regarding his appeal. Mr. Knepfle stated that he received correspondence from the ASRS that was deceptive and this should be considered in reference to his appeal. There were no questions from the Board for Mr. Knepfle.

**Motion:** Mr. Michael Townsend moved to approve Refunds, Death Benefits and Retirements,

*And*

Approve the System Transfers,

*And*

Approve the minutes of the October 21, 2005 Regular Meeting of the ASRS Board,

*And*

Approve the Applications and Agreements with the Following Employer;

- Valley Schools Management Group (effective date January 1, 2006)

*And*

Approve the Recommended Administrative Law Judge's Decision Regarding:

- i. Linda Sloth-Gibbs, but correcting the following: on page four, line 15, A.R.S. § 38-797.01(A) should be changed to A.R.S. § 38-797.07(A)(1); on page four, line 19, A.R.S. § 38-393.01(A)(2) should be changed to A.R.S. § 38-797.07(A)(2); on page four, line 22 and on page six, line 18, A.R.S. § 38-797.01(A)(9) should be changed to A.R.S. § 38-797.07(A)(9).
- ii. William Knepfle, but correcting every statutory reference in the decision from A.R.S. § 38-475 to A.R.S. § 38-745, and correcting every statutory reference in the decision from A.R.S. § 38-475(B) to A.R.S. § 38-745(B).

Mr. Larry Trachtenberg seconded the motion.

By a vote of 6 in favor, 0 opposed, 0 abstentions, and 3 excused, the motion was approved.

Mr. Dave Byers arrived at 9:09 a.m.

### **3. Presentation, Discussion and Appropriate Action Regarding the Plan Actuarial Valuation**

Mr. Charles Chittenden, Actuary, Buck Consultants, and Ms. Eva Yum, Actuary, provided the following statistical information regarding the Plan Actuarial Valuation for year ending June 30, 2005: the ASRS currently has 212,202 active members and 73,853 retired members; the active payroll is \$8.032 billion; the average annual salary is \$37,853; the average annual benefit is \$18,097; the market value of assets is \$21.9 billion and actuarial is \$23.836; the estimated yields on actuarial assets is 3.20% and 8.42% for market; benefits, refunds, and expenses are \$1,533 million and contributions are \$947 million; the external cash flow as percentage of market value is currently -2.68%; the surplus (unfunded accrued liabilities) is \$4,106 million; the GASB #25 funded ratio is currently at 86.1%. Based on the valuation, the contribution rate for the plan for fiscal year 2006/2007 is 8.6%. The permanent benefit increase for 2006 is \$0.00.

**Motion:** Mr. Michael Townsend moved to accept the Plan Actuarial Valuation for the period ending June 30, 2005.

Mr. Larry Trachtenberg seconded the motion

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

#### **4. Presentation, Discussion and Appropriate Action Regarding the Long Term Disability Plan Actuarial Valuation**

Mr. Chittenden informed the Board that the year ending June 30, 2005 LTD Plan Actuarial Valuation was done with the GASB 43 and 45 methodologies which were adopted by the Board last year. Ms. Yum gave a summary of the GASB 43 Methods and Actuarial Assumptions:

##### **Methods:**

Actuarial Cost Method	Projected unit credit
Asset Valuation Method	10-year smoothing of excess earnings effective June 30, 2005
Amortization Method	Level dollar amortization method
Amortization Period	15 years

##### **Assumptions:**

Interest Rate	8%
Rates of Termination of Claims in Payment	1987 Commissioners' Group LTD Valuation Table
Disability Rates for Active Members	Same as Pension Plan
Offsets for Active Members	Net LTD benefit is 68% of gross LTD benefit
Administrative Expense Reserve for Active Members	2.8% of claim liabilities

Ms. Yum stated that the number of LTD open claim members is 4,939, the average age of the member is 53.7, the average monthly benefit is \$1,107, and the total monthly benefit is \$5,465,000. Ms. Yum stated that the funded status as of June 30, 2005 is 28.55%.

**Motion:** Mr. Michael Townsend moved to accept the Long Term Disability (LTD) Plan Actuarial Valuation for the period ending June 30, 2005.

Mr. Larry Trachtenberg seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion was approved.

## **5. Presentation, Discussion and Appropriate Action Regarding the Member Appeal Process**

Mr. Michael Townsend, Chair, Operations Committee, stated that Mr. Anthony Guarino, Deputy Director, Chief Operations Officer, would address the Board regarding the member appeal process. Mr. Guarino stated that at the November Operations Committee (OC) meeting the committee reviewed the agency's appeal process with one thing in mind: do current processes protect and balance member rights with agency interests (total membership interests). Though it did not recommend changing current policies and practices, the OC did conclude that Trustees might benefit by adopting the kind of standardized review used by staff when deliberating appeals at the Board level.

For example, when members first protest an agency decision, the responsible ASRS assistant director is required to resolve the following before concluding on the merits of the appeal: Was the decision or action taken consistent with current agency/vendor practice; are there written procedures; is there a documented executive policy determination; is there an approved or draft Rule; is there clear legislative guidance; has staff been consistent in applying current practice or procedure; was service and counseling timely, reliable and correct; are there precedents to guide a decision? Appeals to the Director's office undergo additional systematic scrutiny before being sent to the Office of Administrative Hearings.

The OC did suggest that the Board consider crafting its own standard review considerations when evaluating an administrative law judge's decision. For example, Trustees might consider the following if they have questions regarding the appropriateness of the agency position or law judge's ruling:

1. Was the member treated equitably?
2. Does the law judges' ruling or agency position somehow serve the total membership's interest?
3. Was the member harmed by unreliable or inadequate staff service?
4. Would ruling in favor of the protesting member set a precedent harmful to the total membership's interest?
5. Do the legal requirements of the case restrict Board action? (Or do legal requirements permit Board discretion?)
6. Is the member presenting additional evidence not reviewed by the judge or staff?
7. Is the evidence of the case clear?
8. Should the Board accept the law judge's ruling, or consider:
  - a. Rejecting the recommended decision?
  - b. Modifying the recommended decision?
  - c. Instructing staff to arrange for a rehearing?

The OC concluded that making the Board review of approvals more consistent and uniform may help ensure that Board decisions more adequately protect and balance member and agency interests.

Mr. Dave Byers commented that separating the appeals from the consent agenda would help to ensure that each appeal is given the time and consideration it deserves. Mr. Byers also stated it would be best for the ASRS staff to provide only facts regarding the appeals and not recommendations to ensure each appeal is clearly considered fairly. Mr. Guarino said these changes would be made.

## **6. Presentation, Discussion and Appropriate Action Regarding Mid-Cap Growth Investment Manager Search**

Mr. Gary Dokes, Chief Investment Officer, addressed the Board regarding the Mid-Cap Growth investment manager search. Mr. Dokes stated that at the October 31, 2005 Investment Committee meeting, the Investment Management Division presented material and recommendations from the U.S. Mid-Cap Growth Search Committee regarding a replacement manager for Forstmann-Leff and Frontier Capital Management, whose assets are currently being managed as part of the E3 portfolio.

Mr. Dokes discussed NorthPointe's investment strategy that focuses on the mid-cap sector of the market with market capitalizations ranging from \$750 million to \$14.2 billion. The specifics of the manager are listed below:

Firm Founded	Firm-wide assets <sup>1</sup>	Strategy Inception	Strategy Assets <sup>1</sup>	Fee (bp) <sup>2</sup>	Expected Alpha (bp) <sup>3</sup>
2002	\$2.5 bil	2002	\$480 mil	54	250

<sup>1</sup> Includes ASRS portfolio amount.

<sup>2</sup> Fee is based on IMD/manager negotiated fee schedule applied to the portfolio amount. IMD negotiations resulted in a 7% fee reduction from the standard fee of 58 basis points.

<sup>3</sup> Expected annual outperformance relative to the S&P 400 Growth index, net of fees. The expected alpha is provided by the manager, not dictated by the ASRS and will vary between manager and asset classes

**Motion:** Mr. Larry Trachtenberg moved to Select and fund NorthPointe Capital with \$140 million as an ASRS U.S. equity mid-cap growth manager,

*And*

Transfer approximately \$140 million (\$110 million from E3 and \$30 million from E4) to NorthPointe,

*And*

Rebalance the value/growth style allocation within the mid-cap asset class to have approximately equal market value style weighting.

Mr. Chris Harris seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion passed.

## **7. Presentation, Discussion and Appropriate Action Regarding Open Meeting Law**

Mr. Tom McClory, Assistant Attorney General, addressed the Board regarding the Open Meeting Law. Mr. McClory stated that due to a recent opinion of the Arizona Attorney General, the use of e-mail could potentially violate the Open Meeting Law. Mr. McClory advised the Board members to use caution when corresponding with other Board members. The Trustees could form a quorum through e-mails and violate the Open Meeting Law. Any decisions made or actions taken as a result of the initial e-mail would be null and void.

## **8. Presentation, Discussion and Appropriate Action Regarding Possible Legislation for the 2006 Legislative Session**

Dr. Meredith explained that this presentation would be a continuation of two particular legislative initiatives discussed at the October 21, 2005 Board meeting. Mr. Patrick Klein, Assistant Director, External Affairs, addressed the Board regarding possible legislation for the 2006 Legislative Session. Regarding the refund of employer contributions there are two options for the Trustees to consider.

Option one would eliminate the ability of a non-retired member who is hired on or after the enactment date of this statutory change to receive any employer contributions when leaving ASRS membership. Current non-retired members would continue to accrue credited service for the purpose of vesting in employer contributions. Current non-retired members would retain the ability to receive a refund of employer contributions upon leaving ASRS membership as currently set in statute.

Option two would eliminate the ability of a non-retired member who is hired on or after the enactment date of this statutory change to receive any employer contributions when leaving ASRS membership. Current non-retired members would be able to receive employer contributions refunds based on the amount of service time the non-retired member has accrued as of June 30, 2007.

In both options incoming non-retired members would only receive employee contributions refunds when leaving ASRS membership. However, Option 2 freezes the amount of employer contributions that a current non-retired member would receive based on the service time accrued as of June 30, 2007. Option 1 continues to allow current non-retired members to receive employer contributions refunds as is currently set in statute.

**Motion:** Mr. Chris Harris moved to approve the public policy initiative to eliminate the ability of an employee who enters ASRS membership after the enactment date of this statutory change to receive any employer contribution refunds if the employee leaves ASRS membership before reaching normal retirement while allowing current ASRS members to be eligible to receive employer contribution refunds based on service time accruals as of June 30, 2007.

Mr. Steve Zeman seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion passed.

Mr. Klein also addressed the issue of the “pop-up/pop-down” benefit for post 2001 members. Statute currently allows a retired member who has selected a period certain or joint and survivor annuity at the time of retirement to rescind their initial pension annuity choice and “pop-up” to a straight life annuity. Later, the retired member could then “pop-down,” returning to the initial annuity choice. The retired member could pop-up and pop-down as many times as a member chooses with no restrictions.

**Motion:** Mr. Chris Harris moved to instruct ASRS staff to provide technical and administrative information to the Legislature regarding the financial impact of the current rescinding of optional forms of retirement benefits statutory provisions upon the ASRS trust fund, including any possible legislation that would reduce or eliminate any resultant financial impact.

Mr. Larry Trachtenberg seconded the motion.

By a vote of 7 in favor, 0 opposed, 0 abstentions, and 2 excused, the motion passed.

## **9. Director’s Report**

Mr. Paul Matson, Director, addressed the Rural Health Insurance Subsidy issue that was discussed during the October 21, 2005 Board meeting. A letter was mailed November 1, 2005 to members in Yavapai and Coconino counties who were either Medicare-eligible retired or disabled. The letter informed the members that the ASRS is extending the open-enrollment period to February 28, 2005. Mr. Matson explained that increasing the flexibility for members has helped to solve some of the problems discussed during the October meeting, but there are still some members who are unhappy without a continuation of the Rural Subsidy.

Mr. Matson stated that there are several issues that will be visited during the December Board meeting. The Board will be presented with information regarding the hiring of securities litigation vendors as well as recommended policy modifications. The Financial Audit will be presented to the Board by the external auditor. The Strategic Plan, which Mr. Matson and Mr. Guarino have been working on, will be presented to the Board. The Trustees will be receiving information regarding Governance Review and the topic will be visited formally during the December Board meeting.

## **10. Possible Presentation and Discussion Regarding Board Committee Updates**

There were no announcements or updates from any of the Committee Chairs.

## **11. Board Requests for Agenda Items**

Dr. Meredith stated that there will be follow up at a future Board meeting to the Coconino and Yavapai County Rural Subsidy issue as discussed earlier in the meeting.

**12. Call to the Public**

No members of the public requested to speak.

**13. The next ASRS Board meeting is scheduled for Friday, December 16, 2005 at 8:30 a.m., at 3300 N. Central Avenue, 10th Floor Board room, Phoenix, Arizona.**

**14. Adjournment of the ASRS Board**

Dr. Meredith adjourned the November 18, 2005 Board meeting at 10:41 a.m.

ARIZONA STATE RETIREMENT SYSTEM

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Anne Schrode, Secretary

Date

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Paul Matson, Director

Date